

Letter of Findings: 08-0586
Sales Tax
For the Years 2005, 2006, and 2007

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ISSUES

I. Sales Tax – Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-8-8; IC § 6-8.1-5-1; IC § 6-8.1-5-4; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the additional assessment of sales tax on sales of tangible personal property.

II. Tax Administration – Ten Percent Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana S corporation, is in the business of selling firearms and accessories, including, but not limited to, ammunition, practice rounds, clay pigeons and memberships. In addition to bank statements, Taxpayer only maintains invoices related to transactions exempt from sales tax ("exempt sales"). Pursuant to an audit, the Indiana Department of Revenue ("Department") assessed additional sales tax based on the best information available at the time of the audit, resulting in an increase of corporate income which later passed through to Taxpayer's two shareholders. Taxpayer and its shareholders protested the assessment. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary. Please refer to Letter of Findings 08-0584, 08-0585, and 08-0587 regarding further information and issues raised by Taxpayer's shareholders in protest of income tax assessments relating to this sales tax protest.

I. Sales Tax – Imposition.

DISCUSSION

Taxpayer had pre-numbered invoices to record its sales including what Taxpayer determined were taxable sales and tax exempt sales for 2005, 2006, and 2007. Taxpayer, however, only retained exempt sales invoices. Since Taxpayer only kept invoices for what it deemed were exempt sales, the auditor determined that the missing pre-numbered invoices were taxable sales, unless Taxpayer could prove otherwise. The auditor further examined Taxpayer's exempt sales records and compared those with the exempt sales Taxpayer had reported to the State of Indiana. Upon review of Taxpayer's exempt sales records, the auditor disallowed sales that Taxpayer had treated as exempt if (1) there was no matching invoice, or (2) there was no exemption certificate provided. After reconstructing Taxpayer's taxable sales, the auditor then used 2005 as a base and divided Taxpayer's reported taxable sales by total taxable sales to arrive at a percentage. From there, the auditor applied the percentage to arrive at Taxpayer's 2006 and 2007 taxable sales.

Taxpayer protested the recharacterization of the above sales as taxable. Taxpayer argued, first, that it had exemption certificates to support its 2005 exempt sales. Taxpayer also argued that the auditor mistakenly counted sales with missing invoices twice, resulting in double assessment of taxable sales. Additionally, Taxpayer claimed that it used some of the missing invoices for insurance or appraisal purposes and, therefore, were likely not available at the time of audit. Taxpayer argues that those "missing invoices" were not and should have never been considered as taxable sales. Taxpayer further claimed that the auditor used the erroneous 2005 result to calculate 2006 and 2007 taxable sales. Taxpayer thus protested that the Department's assessments of Taxpayer's 2005, 2006, and 2007 taxable sales were not correct. Finally, Taxpayer also protested the resulting increase in income to its shareholders which impacted their income tax due (please refer to Letter of Findings 08-0584, 08-0585, and 08-0587).

Indiana imposes a sales tax on retail transactions. IC § 6-2.5-2-1 states:

(a) The person who acquires tangible personal property in a retail transaction is liable for the tax on the transaction and shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction.

(b) The retail merchant shall collect the tax as agent for the state.

Taxpayer is a retail merchant and, therefore, is responsible for collecting and remitting the sales tax.

IC § 6-8.1-5-4(a), in pertinent part, provides:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

IC § 6-8.1-5-1(b), in part, states "[i]f the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest." All tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

A. Exempt Sales

Upon further examining Taxpayer's exempt sales records, the auditor disallowed "exempt sales without invoices" and "exempt sales without exemption certificates." Taxpayer argued that the auditor mistakenly disallowed the "exempt sales without exemption certificates," resulting in additional taxable sales. Taxpayer claimed that it had exemption certificates to support those exempt sales, but the auditor disallowed those exempt sales without asking Taxpayer for those exemption certificates during the audit.

IC § 6-2.5-8-8 states:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

(b) The following are the only persons authorized to issue exemption certificates:

(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;

(2) organizations which are exempt from the state gross retail tax under [IC 6-2.5-5-21](#), [IC 6-2.5-5-25](#), or [IC 6-2.5-5-26](#) and which are registered with the department under this chapter; and

(3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.

(c) The department may also allow a person to issue a blanket exemption certificate to cover exempt purchases over a stated period of time. The department may impose conditions on the use of the blanket exemption certificate and restrictions on the kind or category of purchases that are exempt.

(d) A seller that accepts an incomplete exemption certificate under subsection (a) is not relieved of the duty to collect gross retail or use tax on the sale unless the seller obtains:

(1) a fully completed exemption certificate; or

(2) the relevant data to complete the exemption certificate;

within ninety (90) days after the sale.

(e) If a seller has accepted an incomplete exemption certificate under subsection (a) and the department requests that the seller substantiate the exemption, within one hundred twenty (120) days after the department makes the request the seller shall:

(1) obtain a fully completed exemption certificate; or

(2) prove by other means that the transaction was not subject to state gross retail or use tax.

(Emphases Added).

After the hearing, the Department again requested the missing exemption certificates from Taxpayer. Taxpayer did not produce any certificates or other documentation to support its claim.

Therefore, Taxpayer did not meet its burden of proof to overcome the Department's adjustment of "exempt sales without exemption certificates."

B. Taxable Sales

Based on the pre-numbered invoices, the auditor compiled the invoice numbers that were missing from Taxpayer's records. The auditor determined that those missing invoices were records of taxable sales, unless Taxpayer could prove otherwise. The auditor then divided the total exempt sales invoices by the monthly exempt sales invoices to arrive at an average sales amount for each month. The auditor then multiplied the average sales amount by the number of missing invoices to reach the monthly total of taxable sales in 2005, and from there total sum for 2005. From there, the auditor used the 2005 taxable sales total as a base and applied the percentage, which resulted from dividing Taxpayer's reported 2005 taxable sales by Taxpayer's 2005 taxable sales, to calculate Taxpayer's 2006 and 2007 taxable sales.

1. Missing Invoices

Taxpayer claimed that it used some of the missing invoices for insurance or appraisal purposes, so those missing invoices were not and should have never been considered as taxable sales. Taxpayer claimed that the auditor erroneously characterized those invoices as taxable sales. However, Taxpayer did not provide any documentation to support its claim.

Taxpayer did not meet its burden of proof on this issue.

2. Double Assessment of Missing Invoices

Taxpayer claimed that some of the missing invoices were mistakenly counted twice, resulting in an increase in taxable sales. Taxpayer provided sufficient documentation showing that several missing invoice numbers were

listed twice in the auditor's calculation. A follow-up audit review also agreed with Taxpayer.

Thus, Taxpayer's protest on the duplicate missing invoices is sustained to the extent that the auditor will recalculate the missing invoices in a supplemental audit.

3. Method of Calculation

Taxpayer claimed that the auditor utilized an unreasonable method to calculate taxable sales. Taxpayer first argued that most exempt sales were sales of firearms, which usually were sold at higher prices. Therefore, Taxpayer argued that the Department's determination of average sales amount for each month of 2005 was higher than actual 2005 monthly taxable sales amount, because the auditor used the average sales amount from exempt sales to compute Taxpayer's taxable sales. Taxpayer also argued that the auditor arbitrarily assigned numbers of missing invoices for each month, resulting in unreliable calculation of monthly taxable sales because the auditor could not possibly have known which missing invoices were taxable sales for which specific month. Additionally, Taxpayer argued that the auditor unreasonably used 2005 as a base to assess Taxpayer's 2006 and 2007 taxable sales when its 2006 and 2007 invoices and records were available at the time of the audit.

Here, had Taxpayer maintained all its invoices and necessary records, including taxable sales and exempt sales, as required by IC § 6-8.1-5-4(a), the Department would have no need to reconstruct Taxpayer's taxable sales for those years in question based upon the best information available. Pursuant to IC § 6-8.1-5-1(c), the Department's assessment is presumed to be valid unless Taxpayer can prove otherwise. Had Taxpayer kept complete records regarding its 2005, 2006, and 2007 sales, at the hearing, Taxpayer could have presented its complete record and calculation to overcome the Department's assessment. But, Taxpayer chose not to do so. Taxpayer did not provide any documentation showing its inventory and the pricing differences regarding what it deemed were taxable sales and exempt sales for those years in question. Additionally, Taxpayer did not produce any documentation showing which particular missing invoices should be considered as taxable sales in a particular month. Given the fact that Taxpayer kept its records so poorly, the auditor reasonably reconstructed Taxpayer's sales for those years in question based on the best information available.

Taxpayer did not produce any documentation to substantiate its claim, and, therefore, Taxpayer did not meet its burden of proof to show that the Department over-assessed sales tax.

FINDING

Taxpayer's protest on Subpart B2 is sustained pending the result of the supplemental audit. But, Taxpayer's protest on Subparts A, B1, and B3 are respectfully denied.

II. Tax Administration – Ten Percent Negligence Penalty.

DISCUSSION

Taxpayer also protests the assessment of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and

circumstances of each case.

Taxpayer did not provide any documentation establishing that its failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer is sustained on its protest of the double counted invoices which will be reviewed in a supplemental audit. Taxpayer is denied on all other protest issues.

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